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AN ASSESSMENT OF CORPORATE GOVERNANCE REFORMS IN THE PHILIPPINES: 2002 – 2009

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This paper intends to present an update of the various corporate governance reforms in the Philippines since the adoption of the 2002 Code of Corporate Governance issued by the Philippine Securities and Exchange Commission (SEC). A comparison of these reforms against the Sarbanes-Oxley Act in the United States is also shown. The paper ends by discussing the various assessments conducted by various local and international organizations and how these corporate governance reforms in the Philippines compare with those in our Asian neighbors.

Corporate governance has been a global buzzword in the public and private sectors for more than a decade now. Renewed interest on corporate governance was in full swing especially after the 1997-98 Asian financial crisis and after a spate of international corporate failures and scandals in the early 2000 that rocked some of the more developed and solid economies in the world. Leading the corporate scandals is the high-profile Enron fiasco that robbed many of their investment and retirement money. Against this dwindling public confidence backdrop, corporate governance initiatives and reforms, which aim to restore market integrity and to regain lost trust of investors, were rekindled all around the world. The Philippines, specifically its various regulatory bodies, has implemented many of the reforms recommended by the Organization for Economic Cooperation and Development (OECD), the World Bank (WB), the International Finance Corporation (IFC), the Asian Development Bank (ADB), the Center for International Private Enterprises (CIPE), the International Corporate Governance Network and the Asian Corporate Governance Association to mention a few.

Keywords: Corporate governance, agency problem, separation of ownership and control, OECD Principles

I. INTRODUCTION

In early December 2008, the Legacy Group of Companies, which primarily composed of rural banks and pre-need companies, ceased operations without notifying the SEC. The group – allegedly involved in questionable activities including pyramiding (Dela Peña, 2008; Lucas, 2008; Dalangin-Fernandez, 2009), double-your-

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money schemes (Lucas, 2008; Fernandez, 2009; Fernandez & Marasigan, 2009) and using of fictitious loans to siphon money from the banks[1] – invoked Section 119 of the Corporation Code and filed for voluntary dissolution claiming that continuing the operation is no longer viable and will result in more losses to the greater prejudice of all its stockholders. The depositors and clients of the rural banks were lured to place their hard earned money with the rural banks' "double-your-money" schemes. The closure of the rural banks is aggravated by the payment of the Philippine Deposit Insurance Corporation (PDIC) to 95 percent of Legacy's depositors who were advised to split up deposits in excess of the PDIC's maximum insurable amount of Php250,000 to avail of the deposit insurance protection. Further investigation by Bangko Sentral ng Pilipinas (BSP) revealed massive diversion of funds by said banks using fictitious loans. Many of the bank borrowers admitted to having signed blank documents in consideration of commission fees ranging from Php10,000 to Php15,000 for supposed loans. Falsified documents that had been used to support alleged loans were also discovered. While BSP filed cases against officers and employees of rural banks under the group, no charge against Legacy founder and owner, Celso de los Angeles, was filed due to lack of evidence linking the founder-owner to the alleged scams. The Senate and the House of Representatives had questioned why the SEC and BSP failed to protect the public against companies that solicit funds in trust such as banks and pre-need companies. BSP pointed out that the Legacy Group of rural banks invoked deposit secrecy on the examiners of the BSP. This case not only proves that loopholes in our legal and regulatory framework still exist, but it also shows that the inability of our regulatory bodies in performing their duties can have very costly repercussions to the public.[2] Not only do the victims suffer monetary losses but taxpayers' money will also be used to pay off these victims.

Global Governance Reform Initiatives

Corporate governance reforms have come a long way since the 1997-98 Asian financial crisis and the series of international corporate failures and scandals in the early 2000 that gravely shook investors' confidence around the world. Are they adequate? At the forefront, actively promoting good corporate governance practices is the Organization for Economic Cooperation and Development (OECD), an international organization assisting governments in tackling social, economic and governance challenges in the globalized economy with the end goal of securing economic stability and growth for world markets. Though most of its thirty (30) members are mostly from the developed countries, it has organized many roundtable dialogues with various non-OECD countries notably in Asia, Latin America, and Russia. It recognizes the fact that with the current global economic set up, one local crisis may and can have impact on the financial system worldwide.

The OECD Principles of Corporate Governance or simply known as the "*OECD Principles*" is the leading authority on corporate governance. It was originally issued in 1999 in response to the Asian financial crisis. Through a process of open consultations and dialogues with many non-OECD countries and taking into account developments since 1999, the OECD Principles was revised in 2003 and the new version issued in 2004. Many countries have since adopted the OECD Principles and patterned their national codes of corporate governance on it. However, the first original advocacy of corporate governance came about in the United Kingdom in late 1992. As early as 1990s, United Kingdom already had its share of corporate and accounting scandals. The Financial Reporting Council, the London Stock Exchange and the accounting profession of the U.K. worked together to publish the Cadbury report, which featured how Boards should carry out their "fiduciary" responsibilities to better ensure the reliability of company accounts. The Cadbury report provided a Code of Best Practice as instrument for guiding a director's behavior.

The OECD principles focuses on six key areas of corporate governance. Table 1 summarizes the main areas of OECD Principles with short explanatory annotation. Central to the success of the OECD Principles is that they are principles-based and non-prescriptive so that they retain their relevance in varying legal, economic and social contexts (OECD, 2004).

Table 1
Key Areas of the OECD Principles

I.	***Ensuring the basis for an effective corporate governance framework*** *The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.*
II.	***The rights of shareholders and key ownership functions*** *The corporate governance framework should protect and facilitate the exercise of shareholders' rights.*
III.	***The equitable treatment of shareholders*** *The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.*
IV.	***The role of stakeholders in corporate governance*** *The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active cooperation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.*
V.	***Disclosure and transparency*** *The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.*
VI.	***The responsibilities of the board*** *The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.*

Source: OECD Observer Policy Brief August 2004.

According to OECD, good corporate governance is, first and foremost, to be grounded on a clear and dynamic legal and regulatory framework. Integral to an effective corporate governance framework is the need for laws and regulations to be both enforceable and backed by effective enforcement agencies (OECD, 2004). Unfortunately, though significant reforms and many new corporate governance rules have since been adopted, the danger of complying in form rather than in substance can seriously undermine the effectiveness of these reforms (International Financial Law Review, 2004).

Another salient aspect of the OECD Principles is the establishment of an effective system of checks and balances between boards and management. To avoid possible abuses, professional managers should be effectively monitored by the board. The board is in turn accountable to the shareholders, who should be able to exercise their fundamental ownership rights, including appointing and removing board members. Lastly, to effectively use ownership rights to monitor and influence the board requires basic standards of disclosure and transparency.

II. REVIEW OF LITERATURE

Business theories, practices and principles have been evolving through time as the business environment changes. From a simple "proprietor" business setup, where the owner runs the business, modern corporations have grown so complex not only in its operations but also in its organizational structure and objectives. This complexity leads to the separation of ownership and control, with managers gaining and owners-shareholders losing control. At the heart of the separation of ownership and control is the agency problem, which dominates the corporate governance research. Moreover, as resources become scarce and companies compete intensely for capital, the firm's objective elevates from simply generating short-term economic profit to maximizing shareholders' value, which is the ultimate goal of corporate governance.

While the debates persist on about shareholder value maximization versus short-term economic profit, another dimension of the issue becomes more apparent, resulting in the analysis of how the conflicting objectives of individual participants associated with firms might be aligned so as to yield the hypothesized focus on profit maximization (Cheffins, 2004). This dimension is referred to as the separation of ownership and control. The "corporate revolution" in the United States between 1880 and 1930 put professional managers at the forefront as closely held companies that dominated most industries gave way to large, publicly traded corporations (Cheffins & Bank, 2009). This led to the separation of ownership from control, which is a prevalent characteristic of most modern corporations, particularly public corporations (Bainbridge, 2008-2009). Adolf Berle and Gardiner Means in their 1932 book "The Modern Corporation and Private Property" first introduced such phenomenon, which later will be considered as the fundamental and core problem of corporate governance (Dent, 2005). From an economic perspective, this "conflict of interest" can be better understood using the agency theory, which treats the shareholders as the principal and management as the agent. Agency theory assumes that individuals are rational and maximize their utility, resulting in conflicting interests among managers, shareholders and other corporate constituents (Szilagyi & Batten, 2004). At the very least, information asymmetry exists between owners and managers that is exploited by management (Bedo & Acs, 2007). When corporations lack shareholders who hold sufficiently sizeable stakes to exercise influence over the board of directors and the executives, "agency costs" generated by inattentive or self-serving managers become a major potential concern (Cheffins & Bank, 2009). Under the diffused ownership corporate setting, it is believed that a series of market-oriented constraints are there to properly align to a substantial extent the interests of those running the companies with the interests of those owning the shares (Fischel, 1982; Fama & Jensen, 1983a; Cheffins, 2004). Cheffins (2004) aptly presented the "series of market-oriented constraints" when he explained that "…if a company's executives fail to maximize shareholder value, net earnings will suffer and the share price will decline. This, in turn, will have unpleasant consequences for management. Those in charge can expect to face intrusive scrutiny by skeptical market participants if the company seeks to raise capital and might well take a reputational "hit" in the labor market for executive talent. Moreover, the executives will have to worry about their job security because a 'boardroom coup', a hostile takeover bid and even bankruptcy might be on the cards. The upshot is that the market does much to address the managerial incentive problems created by a separation of ownership and control (p. 593)."

The evils brought about by the separation of ownership and control, have created grave and serious stigma in the minds of the public than the potential benefits it brings especially when stocks crashed amid an epidemic of corporate scandals (Dent, 2005). While Jensen and Meckling (1976) accurately pointed out that issues associated with the separation of ownership and control are associated with the general problem of agency, Shleifer and Vishny (1997) further refined the definition of "control" to include not only management but also large investors with controlling interest. They claimed that the interests of controlling shareholders often do not coincide with that of the minority investors. Claessens, Djankov and Lang (2000) also found that concentrated ownership or control structure, which is predominant in the East Asian corporations, could lead to suppression of minority rights. La Porta, Lopez-de-Silanes, Shleifer and Vishny (2000) mentioned about the expropriation risk (the use of profits by "insiders" to benefit or enrich themselves) faced by the "outsiders" (minority shareholders and creditors). In general, public corporations are rife with asymmetries of information and interests among the various constituents (Bainbridge, 2008). Given all these potential abuses that "insiders" can do to harm "outsiders", a clamor for some semblance of investors protection began to take the form of corporate governance reforms. The intervention of regulatory agencies or lawmakers in the development of corporate governance mechanism is said to be necessary (Echanis, 2006).

Despite the disadvantages brought about by the separation of ownership and control, there are potential benefits to be derived from such an "arrangement". Hessen (1983) appropriately captured the essence of the "potential benefits" when he wrote that investors supply capital because they are willing to entrust to the managerial skills of others. Fama and Jensen acknowledged the benefits arising from a division of labor in a public company set up when they wrote "since decision skills are not a necessary consequence of wealth or willingness to bear risk, the specialization of decision management and residual risk bearing allowed by the unrestricted common stock enhances the adaptability of a complex organization to changes in the economic environment (Fama & Jensen, 1983b)." Demsetz (1983) also assented, saying that "specialization of business activity into…ownership of the corporation and…managerial control…raises the utility level achievable by those with funds to invest and those with managerial skills to sell" (p. 383). The chief economic virtue of the public corporation is not that it permits the aggregation of large capital pools, but rather that it provides a hierarchical decision-making structure well-suited to the problem of operating a large business enterprise with numerous employees, managers, shareholders, creditors, and other inputs (Bainbridge, 2008). "Arrow aptly captured this: Under conditions of widely dispersed information and the need for speed in decisions, authoritative control at the tactical level is essential for success" (Bainbridge, 2008-2009, p. 31). From the given arguments, it can be inferred that the inherent weaknesses caused by the separation of ownership and control in modern corporate setting are unavoidable and must be accepted and dealt with.

Given the dominance of large, publicly-traded companies in the contemporary business landscape of almost all nations worldwide, issues and problems related to the separation of ownership and control or agency problem cannot be ignored. Renewed interest on corporate governance, which is seen as the cure to the spate of corporate scandals and fiascos of the recent decade, has flourished. Developed as well as emerging markets are creating and adopting corporate governance reforms left and right. Shareholders are demanding that their "interest" be protected from unscrupulous managers or they will be forced to move their resources/wealth elsewhere. Apparently, the agency problem dominates the corporate governance research as correctly observed by Jensen and Meckling (1976). Echanis (2006) even defined corporate governance as the structure and process by which the public corporations control agency problems. Both developed and emerging markets have been adopting the OECD Principles, which has become the leading authority on corporate governance. The OECD Principles aims precisely to eliminate the agency problems that are rampant in the corporate setting by advocating core values like fairness, transparency, responsibility and accountability.

In the aftermath of some high profile financial scandals such as Enron (2001), WorldCom (2002) and Global Crossing (2002) that assaulted one of the more solid economies in the world, the United States signed the Sarbanes-Oxley Act (SOX) into law in 2002. While some consider that the Sarbanes-Oxley Act has brought the most extensive reforms to the U.S. financial markets since the enactment of the Securities Act of 1933 and the Securities Exchange Act of 1934 (Cheung, 2006), still some think that it merely improves the financial reporting (Echanis, 2006; Dent, 2005). Its goals are said to be modest, being limited primarily to deterring and catching illegal acts (Dent, 2005). According to Dent, the Sarbanes-Oxley Act is not the solution to the corporate governance problem.

Moreover, while some of the market-oriented mechanisms such as monitoring by outside directors, performance-oriented compensation and the market for corporate control can help align the interest of management and shareholders, the wholesale destruction of shareholder value in major publicly traded U.S. financial corporations during the recent market turmoil (e.g., AIG, Bear Stearns, Citigroup and Lehman Brothers) illustrate that major gaps in managerial accountability remain (Cheffins & Bank, 2009). Dent (2005) even went a step further and claimed that prior reforms did not cure the ills of corporate governance and there is little reason to think that the recent spate of reforms will be any more effective. Unless reforms hit the separation of ownership and control issue squarely, no reform can really succeed (Dent, 2005). Notwithstanding the gloomy views on the "cures" that corporate governance reforms can bring, the various benefits of good governance cannot be discounted. IFC reported that "good governance won't just keep your companies out of trouble. Well-governed companies often draw huge investment premiums, get access to cheaper debt, and outperform their peers."

(International Finance Corporation, 2005). In a 2002 McKinsey survey, it was found that institutional investors were willing to pay as much as 22 percent premium in well-governed companies in Asia. For emerging economies in Asia, regulatory reforms focused on enhancing the property rights of investors, notably by improving the corporate governance framework by maintaining the competitiveness of capital markets, providing legal protection for investors (better property rights) and enhancing the role of outside shareholders within the individual country, are said to be critical factors leading to long-term sustainable growth (Szilagyi & Batten, 2004). Asian Corporate Governance Network's concluding remark in its presentation to Moody's crowd in June 2009 articulately depicts the prospects of corporate governance work saying that "corporate governance reform is a dynamic and continuous process…reform efforts are never perfect or complete, but without them investor confidence and trust would not return. The corporate governance regimes in Asia have improved since 1997, but there is still a lot of work to do" (Allen, 2009a, p. 19). Holmstrom and Kaplan likewise concur to this line of reasoning when they wrote: "Despite the alleged flaws in its governance system, the U.S. economy has performed very well, both on an absolute basis and particularly relative to other countries…the broad evidence is not consistent with a failed U.S. system. If anything, it suggests a system that is well above average" (in Bainbridge, 2008-2009, p. 34). Corporate governance problems are quite complex, owing to differing cultural, social and political factors across economies (Macey & O'Hara, 2001); it will indeed take some time for a tenable solution to be reached.

III. METHODOLOGY

To present the corporate governance reforms adopted in the Philippines and how these fare vis-à-vis international standards, the following activities were undertaken:

1. Determine the various reforms undertaken by the various regulatory agencies in the Philippines and compare these reforms against those of other selected Asian neighbors;
2. Compare the various reforms undertaken in the Philippines with the provisions of the Sarbanes-Oxley Act; and
3. Survey the assessments of various local and international bodies on the corporate governance reforms done in the Philippines.

IV. CORPORATE GOVERNANCE FRAMEWORK IN THE PHILIPPINES

Regulatory Bodies

The SEC is the government agency having overall jurisdiction, supervision and control over all domestic private corporations. It also supervises and regulates investment companies, investment houses, stock brokerages and pre-need plan companies. Moreover, it ensures that self-regulatory organization (SRO) like the Philippine Stock Exchange performs its functions as a SRO in accordance with SEC-approved SRO rules and the Securities Regulation Code. With the promulgation of the Securities Regulation Code (Republic Act No. 8799), SEC's power is further strengthened. Appendix 1 provides a complete list of the powers and functions of the SEC as enumerated under Section 5 of the Securities Regulation Code (Republic Act No. 8799).

Helping the SEC are the Philippine Stock Exchange (PSE), the Bangko Sentral ng Pilipinas (BSP) and the Office of the Insurance Commission (IC). Each is in charge of a particular financial market sector and each has autonomy to issue its own circular memoranda and IRRs as long as they are not contrary to any existing laws. The PSE is a self-regulatory organization (SRO) that provides a marketplace where investors, listed companies and other market participants can trade securities. It oversees all publicly-listed companies. The BSP has supervision over the operations of banks and exercises such regulatory powers over the operations of finance companies and non-bank financial institutions performing quasi-banking functions. The IC, on the other hand, is an agency under the Department of Finance which supervises and regulates the operations of life and non-life companies, mutual benefit associations and trusts for charitable uses.

Regulatory Framework

Though the Philippines is spared from major catastrophic scandals like the Enron and severe financial crisis like the US sub-prime mortgage meltdown, many sectors in the country have joined the corporate governance bandwagon. Even before the Bush administration in the United States passed the Sarbanes-Oxley Act of 2002, paving the way to upgrade Philippine corporate governance practices are the enactment of some important legislations. Among them are: the Securities Regulation Code (SRC) of 2001 (Republic Act No. 8799) and the General Banking Act (GAB) of 2000 (Republic Act 8790). The SRC revised previous laws governing the regulation of securities in the Philippines and reorganized and empowered the SEC. According to the World Bank Corporate Governance Country Assessment on Philippines in May 2006, among the SRC's important new provisions are: (a) the institutional strengthening of the SEC and the strengthening of its prosecution and enforcement powers; (b) the clarification of the scope of insider trading and market manipulation, protection of minority investors through the requirement of a mandatory tender offer; and (c) the delegation of certain regulatory powers to self-regulatory organizations (SROs) such as the PSE. The GAB, on the other hand, prescribed the "fit and proper rule" that required bank directors to undergo training in corporate governance practices before the Monetary Board (MB) confirms their appointment as directors. The SEC has less stringent rule and requires training of directors only if such requirement is stated in the Manual of Corporate Governance of the said company.

Various laws and regulations have been passed to protect the interest of the investing public. The Securities Regulation Code and the Corporation Code of the Philippines are two of the many laws under the purview of SEC that are geared toward the attainment of such goal. While lawmakers acknowledge the need to pass laws, rules and regulations to uphold and protect the basic rights of an investor, investors, on their part, should know their rights and should exercise them to enjoy the protection and full extent of the benefits of these rights. After all, the investor is the most effective regulator. No one has the same drive and priority as the investor when it comes to protecting his investment. Appendix 2 shows a list of the laws that SEC has regulatory and administrative jurisdiction with a brief description of each law.

Central to SEC's corporate governance thrust is the issuance of Memorandum Circular No. 2, Series of 2002, otherwise known as the Code of Corporate Governance and the Manual of Corporate Governance. Both are aimed to provide guidance to companies in the formulation of their governance rules and practices. In fact, many Asian countries started to adopt a code of corporate governance in the early 2000 as compliance to recommendations by international organizations like the OECD and World Bank. Below are two tables showing the drastic change in landscape of best practices in 1997 and in 2009.

Table 2
A Barren Landscape of Best Practices in 1997

Country/Market	Was there an official code of best practice?	Did the idea of the "independent director" exist?	Did the idea of the audit committee exist?
China	None	None	None
Hong Kong	Yes (but very short)	Yes	Yes
India	None	None	None
Indonesia	None	None	None
Japan	None	None	None
Korea	None	None	None
Malaysia	None	Yes	Yes
Philippines	None	None	None
Singapore	None	Yes	Yes
Taiwan	None	None	None
Thailand	None	None	None

Source: ACGA research

Table 3
A Dense Jungle in 2009

Country/Market	Date of main code(s)	Are "independent directors" required?	Are audit committee required?
China	2002/2005	Yes	Yes
Hong Kong	1993/2004	Yes	Yes
India	1999/2005/2007	Yes	Yes
Indonesia	2001/2006	Yes	Yes
Japan	2003/2004	Optional	Optional
Korea	1999/2003	Yes	Yes (for large firms)
Malaysia	2001/2007	Yes	Yes
Philippines	2002/2009	Yes	Yes
Singapore	2001/2005	Yes	Yes
Taiwan	2002/2006	Yes (certain firms)	Yes (certain firms)
Thailand	1999/2006	Yes	Yes

Source: ACGA research

Financial reporting guidelines dominated most of the corporate governance circulars issued by the SEC. This confirms findings that the main thrust of corporate governance reforms in the Philippines is on improving and strengthening of accounting and auditing standards (Echanis, 2006; International Financial Law Review, 2004). Moreover, the SEC amended SRC Rule 68, the Special Accounting Rules, to conform to International Accounting Standards (IAS). Effective 2005, most publicly-listed companies in the country are IAS-compliant. Another major SEC thrust is the accreditation of auditing firms and external auditors. Guidelines to on accreditation and reportorial requirements are there to regulate the quality of work done by the accounting and auditing profession.

The rationale behind SEC's focus on financial reporting and external auditor accreditation guidelines is that many investment decisions are financial in nature. Prospective investors, as well as shareholders and stakeholders, rely primarily on financial statements issued by the firms to make critical decisions. SEC recognizes the importance of adopting globally accepted accounting and auditing standards to prop up investments in the country. Moreover, a number of highly publicized corporate scandals involving fraudulent reporting have dramatized the need for vigilance over financial reporting practices (Agustin, 2002-2003). How these fraudulent financial reporting practices escaped the attention of the external auditors raised the ire of the investing public and cast very serious doubts on the "independence" of external auditors from their clients. Instead of lending credibility to the fairness of the financial statements prepared by companies, these external auditors have become mere rubber stamps of companies. To ensure fair reporting and raise the level of audit rigor to protect investors, SEC has been issuing various guidelines on financial reporting and accreditation of external audit firms and auditors.

While SEC has made leap and bounds progress in terms of laws and regulations to enhance corporate governance, there are two major areas that direly need improvement in the Philippines namely, in the enforcement of compliance and in the imposition of higher sanctions and penalties for violators.

As per SEC Memorandum Circular Nos. 8 and 13 Series of 2009, the scales of fines for various violations are listed. To give the reader an idea of the severity or magnitude of the fines imposed, below is a condensed table showing how an audit firm handling Group A companies will be penalized for each pertinent violations:

	First Offense	**Second Offense**	**Third Offense**
Violation of reportorial and representation obligation	Php25,000	Php50,000	Php100,000
Violation of the independence requirements	Php25,000	Php50,000	Php100,000
Violation of accreditation requirements	Php100,000	Php200,000	Php400,000

Likewise, reporting companies that do not comply with the financial reporting requirements of the SEC, specifically material misstatements in financial statements, are also penalized with fines. The scales of fines are given in SEC Memorandum Circular No. 8, Series of 2009. For a first offender, the fine for a Php10 million or above misstatement in the financial statement is only 1/10 of 1 percent of the amount misstated or an amount given in the table (maximum is Php4,000), whichever is higher. 1/10 of 1 percent of Php10 million misstatement translates only to Php10,000. In the same way, the penalties and fines imposed by the PSE on publicly-listed companies are considered very minimal also. Non-compliance with structured disclosure requirements as prescribed under Section 17 to 17.15 of the Disclosure Rules will result in the imposition of a maximum penalty per year/per violation of only P500,000 for a publicly-listed company with total assets of P1.0 billion and above. In the World Bank ROSC study in 2006, it was recommended that the scales of fines be set high enough to deter any violations. Not only will the imposition of higher fines and penalties deter violations but it can enable the regulatory bodies to hire and employ the best human and capital resources to effectively perform their functions.

The above arguments are validated by findings reported by Cheung (2006) that some Asian countries have difficulties in enforcing their laws due to a lack of resources and high levels of corruption. In fact, according to OECD's report in 2006, the Philippine regulatory bodies are not well staffed and well funded compared to our Asian neighbors. Cayanan (2007) pointed out that the prevalence of non-compliance to financial reporting rules stems from inadequate sanctions and investor apathy. He noted that "no one has yet been imprisoned for not complying with financial reporting standards" in the Philippines. Moir (2006a) also wrote that the tone and quality of regulatory frameworks differ greatly across Asia, as the crucial element of enforcement. ACGA and Credit Lyonnais Securities Asia (CLSA) reported that while reporting standards are improving and companies are responding to demands for quicker information, enforcement of these regulations are often lacking. The ACGA-CLSA report referred to this as "traditionally the weak spot in Asian regulatory regimes" (Moir, 2006a).

Both the BSP and the IC were also keen contributors to the good governance cause. BSP published the Manual of Regulations for Banks (MORB) and the Handbook on Corporate Governance for Banks. Both agencies also issued their own Circulars on corporate governance principles and leading practices.

The PSE, which was conferred the status of a self-regulatory organization (SRO), is implementing its own rules and imposing penalties on erring trading participants and listed companies.[3] This is in compliance with the International Organization of Securities Commissions (IOSCO) Objectives and Principles of Securities Regulation mandate of making appropriate use of SROs to exercise some direct oversight responsibility for their respective areas of competence.

In line with SEC's thrust toward upholding good corporate governance, PSE has also stepped up its role in instigating ways and means to instill awareness and promote corporate governance among publicly listed companies. Many of the initiatives pursued by PSE are on ensuring adequate disclosures.

Local Organizations Promoting Corporate Governance Best Practices

The SEC, BSP, IC and PSE are not the only institutions actively involved in the promotion of good governance in the country. Also doing its part is the Institute of Corporate Directors (ICD), a World Bank-funded non-profit organization. The ICD is instrumental in institutionalizing the Corporate Governance Scorecard (CGSC) for publicly listed companies in 2005. The 2009 Corporate Governance Scorecard for Publicly-Listed Companies was developed by ICD in collaboration with the SEC, the PSE and the Ateneo Law School. This can be accessed through the ICD website. The

SEC initially required publicly-listed companies to voluntarily submit the CGSC, but beginning 2009 as per SEC Memorandum Circular No. 12, this was made mandatory with penalties specified in SEC Memo Circular No. 5 Series of 2009. Aside from creating the Corporate Governance Scorecard, ICD is also a SEC- and BSP-accredited training provider on corporate governance.

The Philippine Institute of Certified Public Accountants (PICPA), the national organization of CPAs, working with the Board of Accountancy (BOA) and the Professional Regulation Commission (PRC), also undertook various initiatives in promoting good governance. Among them are: the establishment of a Quality Assurance Board, tasked to ensure the quality of Philippine CPAs and to monitor and support pending legislation regarding the accountancy profession and the creation of a Quality Review Committee, tasked to ensure the quality of work by external auditors. To date, only the Quality Control Review Committee has not been constituted although a model for quality control review has been prepared. With the approval of the New Accountancy Law (Republic Act No. 9298), PICPA is tasked with the strict enforcement of continuing professional education for CPAs.

The Philippine Code of Corporate Governance

The Philippine Code of Corporate Governance (Code) was issued by the SEC. This Code supplements and complements the Securities Regulation Code and the Corporation Code. It is patterned after the OECD Principles. But while the OECD Principles seem to focus equally on all the six main areas, the bulk of the Code is devoted in the discussion of board governance. Just like Thailand and Malaysia, the Code covers only five areas and omits OECD's first key principle of creating the basis for an effective corporate governance framework, which is a clear and dynamic legal and regulatory framework with laws and regulations that are both enforceable and backed by effective enforcement agencies. Only the Indonesia's Code of Good Corporate Governance is able to touch briefly on the first OECD key area.

The Code's main focus is on board governance. It considers the Board of Directors or simply the *Board* to be primarily responsible for the governance of the corporation. The main role of the Board is to act as an independent check on management. In order to effectively exercise its monitoring and oversight functions over management, it is essential that a number of board members should be independent from management. Some of the points discussed under board governance take off from the Corporation Code of the Philippines. However, many items are added to make the contents of the Code more aligned to the current and evolving corporate governance practices. Table 4 provides a comparison between the Corporation Code and Code of Corporate Governance on corporate governance.

Table 4
Comparison between Corporation Code and SEC's Code of Corporate Governance on Board Governance

Corporation Code of the Philippines	Code of Corporate Governance 2002
Composition of the Board Sec. 14 #6 The number of directors or trustees which shall not be less than five (5) nor more than fifteen (15).	Publicly listed companies should have at least two (2) independent directors or such independent directors shall constitute at least twenty percent (20%) of the members of such Board, whichever is lesser.
No provision	Board must come up with a balance number of executive and non-executive directors with clear division of responsibilities.
No provision	Non-executive directors should possess sufficient qualifications, stature, and number to function properly.
Multiple Board Seats No provision	Maximum number of directorship that a member can assume is capped by his ability to perform his duties diligently.
The Chairman and the CEO Sec. 25 Any two (2) or more positions may be held concurrently by the same person, except that no one shall act as president and secretary or as president and treasurer at the same time.	It is preferred that chairman and CEO are not to be same person. It is also required that relation between chairman and CEO be disclosed upon their election.
Qualifications of a Director Sec. 23 Every director must own at least one (1) share of the capital stock of the corporation of which he is a director, which share shall stand in his name on the books of the corporation.	Aside from the one share ownership, the company may impose additional qualifications as it sees fit like education attainment, business experience, practical understanding of the business.
Disqualifications of a Director Sec.27 No person convicted by final judgment of an offense punishable by imprisonment for a period exceeding six (6) years or a violation of the Corporation Code committed within five (5) years prior to the date of his election or appointment shall qualify as director, trustee or officer of any corporation. Sec. 28 Any director or trustee of a corporation may be removed from office by a vote of stockholders holding or representing at least two-thirds (2/3) of the outstanding capital stock…Removal may be with or without cause: Provided, that removal without cause may not be used to deprive minority stockholders or members of the right to representation to which they may be entitled under Section 24 of this Code.	The Code specifies more than one ground for disqualification of directors though Sec. 27 of the Corporation Code is one of them. It also enumerates grounds for temporary disqualifications.
Duties, Functions and Responsibilities of a Director Sec. 34 Where a director, by virtue of his office, acquires for himself a business opportunity which	The Code states that the Board's primary duty is to act for the best interest of the corporation. It

Corporation Code of the Philippines	Code of Corporate Governance 2002
should belong to the corporation, thereby obtaining profits to the prejudice of the corporation, he must account to the latter for all such profits by refunding the same, unless his act has been ratified by a vote of the stockholders owning or representing at least two-thirds (2/3) of the outstanding capital stock. This provision shall be applicable, notwithstanding the fact that the director risked his own funds in the venture.	further expounds on the general and specific duties of a director by giving a list.
Board Meetings and Quorum Requirements Sec. 53 Regular meetings of the board of directors or trustees of every corporation shall be held monthly, unless the by-laws provide otherwise. Special meetings of the board of directors or trustees may be held at any time upon call by the president or as provided in the by-laws.	Directors should regularly attend meetings. Teleconferencing is now allowed. Independent directors should attend meetings always. Justifiable causes for absence by independent directors are specified.
Remuneration of the Members of the Board and Officers Sec. 30 In the absence of any provision in the by-laws fixing their compensation, the directors shall not receive any compensation, as such directors except as reasonable per diems: Provided, however, that any such compensation other than per diems may be granted to directors by the vote of stockholders representing at least majority of the outstanding capital stock at a regular or special stockholders' meeting. In no case shall the total yearly compensation of directors, as such directors, exceed ten percent (10%) of the net income before income tax of the corporation during the preceding year.	No compensation amount is specified by the Code. However, compensation should be attractive enough to attract and keep directors and officers. Compensation of the CEO and the four highest paid executive officers should be disclosed in the annual report.
Board Committees Sec. 35 The by-laws of the corporation may create an executive committee, composed of not less than three (3) members of the board, to be appointed by the board. Said committee may act, by majority vote of all its members, on such specific matters within the competence of the board, as may be delegated to it in the by-laws or on a majority vote of the board, except with respect to: (1) approval of any action for which shareholders' approval is required; (2) the filling of vacancies in the board; (3) the amendment or repeal of by-laws or the adoption of new by-laws; (4) the amendment or repeal of any resolution of the board which by its expressed terms is not amendable or repealable; and (5) a distribution of cash dividends to the shareholders.	Committees should be formed to help the Board in the proper execution of its functions. The Code recommends the constitution of three committees – audit, nomination and compensation – their composition and duties and functions.
No provision	***Corporate Secretary*** The Code defines the corporate secretary's qualifications and duties.

Understanding the Code of Corporate Governance will be more meaningful when read in tandem with the ICD Corporate Governance (CG) Scorecard. Though the CG Scorecard is formulated based on the Code of Corporate Governance, the survey questions, description and suggested information source in each key area provide a rich source of information for corporations to bring their corporate governance practices to the next higher level.

In 2009, SEC issued Memorandum Circular No. 6 referred to as the Revised Code of Corporate Governance. The revised version of the Code is merely an update of the original version. Some parts are modified to better phrase some provisions. These revisions are considered minor as the true essence and spirit of the original Code remains intact.

The Sarbanes-Oxley Act of US and the Philippine Corporate Governance Reforms: A Comparison

Comparing the specific mandates in the Sarbanes-Oxley Act with the various regulations and initiatives that our local regulatory bodies have issued and adopted provides updates on the state and direction of our governance efforts. Table 5 shows an overview of the contents of the Sarbanes-Oxley Act vis-à-vis reforms taken by our regulatory agencies. The table is simply illustrative and informative rather than comprehensive.

Table 5
Sarbanes-Oxley Act vs. Philippine Provisions

Sarbanes-Oxley Act	Reforms Adopted in the Philippines
Title 1: Public Company Accounting Oversight Board (PCAOB) The PCAOB is tasked to provide independent oversight on public accounting firms. Among its many functions are: registration of auditors, establishment of audit, quality control and independence rules, inspection of registered public accounting firms, and enforcing of specific mandates of the Act with investigation and disciplinary powers.	The oversight of the audit profession rests mainly with the Board of Accountancy (BOA). Though the Revised Accountancy Law of 2004 (Republic Act No. 9298) mandated the creation of the Quality Review Committee to provide oversight on quality of audits done by external auditors/audit firms, its implementation is yet to be seen. The Philippine Standards on Auditing No. 220 “Quality Control for Audit Work” provides guidance on the quality control policies and procedures that an audit firm should adopt.
Title 2: Auditor Independence • Auditor prohibited to perform non-audit services (such as bookkeeping and other accounting services, financial information system design and implementation, internal audit, etc.) for audit clients	• This is being covered in the Code of Ethics for CPAs and also in the SEC Memorandum Circulars on Guidelines on Accreditation of Auditing Firms and External Auditors.
• Approval of new auditor	• As per SEC Memorandum Circular No. 6 Series of 2004, the audit committee of the company is to recommend to the Board the external auditor to be appointed.
• Audit partner rotation policy	• This is covered in SEC Memorandum Circular No. 8 Series of 2003. This requirement also forms part of

Sarbanes-Oxley Act	Reforms Adopted in the Philippines
	the Corporate Governance Self-Rating Form as per SEC Memorandum Circular No. 5 Series of 2003.
• Conflict of interest issues • Auditor reporting requirements	• This is covered in the Code of Ethics for CPAs. • This is covered in SEC Memorandum Circular No. 13 Series of 2009, which supersedes SEC Memorandum Circular No. 13 Series of 2006 and No. 13 Series of 2003. Material findings related to fraud, error, losses or possible losses should be disclosed to SEC by reporting company. If this disclosure is not made by reporting company, then the external auditor should report this to SEC.
Title 3: Corporate Responsibility • Audit Committee of publicly-listed companies • Corporate responsibility for financial report (CEO and CFO to certify the veracity of the financial statement)	• This is covered in the Code of Corporate Governance issued by SEC. • Amended SRC Rule 68 and 68.1 requires that all financial statements filed shall be certified by the chairman of the board. Signing with the Chairman are the CEO and CFO.
Title 4: Enhanced Financial Disclosure	• The SEC and PSE prescribe the "full disclosure approach". PSE Revised Disclosure Rule requires that material information should be disclosed to PSE within 10 minutes from the receipt of such information. • The SRC requires the disclosure of director information regarding their capacity to hold office and their track record in the company and in other companies where they hold directorship. • The amended SRC mandates disclosure by any person who is directly or indirectly the beneficial owner of more than 5 percent and beneficial owner of 10 percent or more of the equity security of the company or by a director, officer or stockholder thereof. SEC and PSE also monitor ownership disclosures through the General Information Sheet (GIS) and Statement of Changes of Beneficial Ownership, respectively. • IAS 24/PAS 24 sets the rules on the disclosure of related party transactions. • Details of remuneration of directors and key officers, both individually and in aggregate, should be disclosed in the annual report. • Corporate actions such as issuance of securities, public offering of stocks, material changes in registration statements, merger, decrease of capital stock, dissolution and withdrawal of license of corporations should be published in newspaper of general circulation before they become effective as per SEC Memorandum Circular No. 1 Series of 2008.
Title 5: Analyst Conflict of Interest This section provides the code of behavior that securities analysts should adopt with the goal of fostering greater public confidence in securities	• The amended SRC Rule 30.2 requires disclosure by brokers/dealers and traders regarding conflict of interest with customers. • Amended IRR of SRC Rule 34 requires that

Sarbanes-Oxley Act	Reforms Adopted in the Philippines
research. It discusses how securities analysts can protect their objectivity and independence.	broker/dealer, analyst or rating agency which has material interest in a transaction, neither advise nor deal in such transaction. Moreover, SRC Rule 61 and 63 discuss the civil and criminal liability of brokers/dealers and associated persons who practice insider trading. Administrative penalties are also covered in SEC Memorandum Circular No 6 Series of 2005. • The PSE issued a Code of Conduct and Professional Ethics for Traders and Salesmen.
Title 6: Commission Resources and Authority This section provides the guidelines on how to improve the oversight and disciplinary functions of the Commission via acquisition of additional human and technological assets.	Securities Regulation Code of 2001 reorganized and empowered the SEC. While the SRC exempts the SEC from the Salary Standardization Law and provides for a compensation structure commensurate to that of the BSP, the salary level of the SEC staff hardly compares with that of the BSP staff. SEC has the authority to enforce laws and regulations but it does not have adequate resources in terms of both technical expertise and number of professionals according to the World Bank study in 2006. (Source: ROSC Corporate Governance Country Assessment on Philippines May 2006)
Title 7: Studies and Reports This section aims to fortify SEC's position on corporate issues via the commissioning of researches.	None
Title 8: Corporate and Criminal Fraud Accountability This section specifies criminal penalties for fraud by manipulation, destruction or alteration of financial records or other interference with investigations while providing protection to whistle-blowers.	None
Title 9: White Collar Crime Penalty This section supports the increase of criminal penalties associated with white-collar crimes and conspiracies. It recommends stronger sentencing guidelines and cites failure to certify corporate financial reports as criminal offense.	There is no specific rule on protection of whistleblowers. However, Republic Act No. 6981 provides protection to person who has witnessed or has knowledge on the commission of crime and has testified or is testifying before any form of investigating body.
Title 10: Corporate Tax Return	Bureau of Internal Revenue Regulation No. 3-2010 requires the president/CEO and CFO (or holder of equivalent positions) to sign a statement of management's responsibility for their company's annual income tax returns.
Title 11: Corporate Fraud Accountability This section identifies corporate fraud and tampering as criminal offenses and relates them with specific penalties. It also grants SEC the authority to temporarily freeze unusual transactions.	None

From Table 5, it can be concluded that the various Philippine provisions are at par with majority of the items in the Sarbanes-Oxley Act.[4]

Aside from weak enforcement of compliance and imposition of small fines and penalties, two glaring shortcomings in the Philippine corporate governance reforms are: 1) the lack of provision and protection for whistle-blowing in the Philippines; and 2) the absence of serious penalties associated with fraud. High profile fraud and corruption scandals at companies worldwide have raised the importance of reporting executive misbehavior. However, the cultural inhibitions and local business structures prevalent in Asia make it tough for these countries to implement programs to encourage and protect those who speak out (Moir, 2006b). Moir (2006b) wrote that though there is general agreement that whistle-blower legislation should be introduced to protect people from reprisals, it will certainly take some time to surmount cultural barriers.

The Philippine Bureau of Internal Revenue (BIR) likewise recently took a step forward and issued in February 2010 Revenue Regulations No. 3-2010. This new regulation has the same provisions as Title 10 Corporate Tax Return in the Sarbanes-Oxley Act. It requires the president/CEO and CFO of the company to sign a statement of management's responsibility for their company's annual income tax returns. The statement of management responsibility prescribed by the BIR does not replace a similarly named document that reporting companies are required to submit to the SEC together with their audited financial statements. Although the substance of the two statements appears the same, they have different goals. While it is BIR's goal to ensure the correct collection of taxes, it is SEC's objective to compel companies to submit a fairly accurate picture of their financials to the investing public. The fact that an independent or external auditor reviewed and confirmed the adherence to accounting rules does not diminish the responsibility of the company officers over their contents. These two statements have accountability as their end goal.

V. ASSESSMENT OF CORPORATE GOVERNANCE REFORMS IN THE PHILIPPINES

Assessments by Local Organizations

Many studies have been conducted to assess and evaluate the progress of corporate governance reforms in the country. The level of compliance of listed Philippine companies with respect to financial reporting standards is still far from ideal (Cayanan, 2007), though discernible improvements were noted in the series of studies[5] made by various faculty of the UP College of Business Administration. While these studies focused on the common financial reporting violations, the 2007 study by Cayanan went beyond the usual premise and determined motivations for listed Philippine companies from complying with the financial reporting standards. It was found that regulated companies have higher incidence of compliance and companies requiring external financing of any form have a higher motivation to window dress their accounts in order to boost their chance of raising funds and lower their cost of financing.

The CG scorecard project, which the ICD holds every year, contains a ranking of firms with high, low or no corporate governance practices. Basically, the 2008 average scores of listed companies improved from 65 percent in 2007 to 72 percent in 2008. Ayala Land Inc., which garnered the top slot in the 2005 CGSC with a CG Score of 72.91

percent, reported a 30 percent improvement in 2007 with a CG Score of 94.64 percent. The PSE commissioned Yan-Leung Cheung (School of Business, Hong Kong Baptist University, Hong Kong) to examine the relationship between corporate governance and firm value in the Philippines. The result of this independent study affirms the trend of the ICD CGSC scores, indicating that corporate governance practices improved during 2005 to 2008. The most significant improvement was found during 2006-07. Moreover, the study shows that firm valuation is directly related to the level of corporate governance and changes in corporate governance practices. It also suggests that Philippine investors are more sensitive to changes in the rights of shareholders, disclosure and transparency and Board governance. These findings may provide our regulatory bodies with valuable insights on what and where to focus. It affirms SEC and PSE's focus on Board governance as embodied in its Code of Corporate Governance and Manual of Corporate Governance and on disclosure and transparency, respectively, are on the right track. Efforts should be focused on the strengthening of shareholder rights.

Another study, which was recently concluded by the Hills Program on Governance of the Asian Institute of Management (AIM), entitled "Corporate Governance Trends in the 100 Largest Publicly-Listed Companies in the Philippines, 2002 to 2007" assessed the state of corporate governance in the country and re-evaluated the effectiveness of the existing corporate governance rules, regulations and guidelines. The 100 largest companies were selected based on their reported revenues in 2007. Based on disclosures in the annual reports from 2002 to 2007, compliance by most of the 100 largest publicly listed companies with the rules, regulations and guidelines relating to corporate governance appeared to have been minimal. However, there appeared to have been marked improvements in certain governance practices since 2005. This finding confirms the above two studies conducted by the ICD and commissioned by the PSE. Appendix 3 presents some of the salient findings of the AIM study.

Assessments by International Organizations

Though the Philippines response to the global problem of corporate governance is adequate in terms of the promulgation of rules and regulations, regulatory bodies, however, need to be reformed and strengthened to improve implementation and enforcement of the corporate governance rules and regulations according to the Report on the Observance of Standards and Codes (ROSC) Corporate Governance Country Assessment on Philippines in May 2006 by the World Bank. As stressed by the first OECD key Principles, effective corporate governance is only possible if the laws and regulations are enforceable and backed by effective enforcement agencies. We have the laws and regulations, but we need effective and impartial authorities to execute their functions in order to enforce what the laws and regulations are there to achieve and protect. The World Bank study provided valuable insights on the state of corporate governance in the country and recommended ways to further improve corporate governance reforms. Among the steps suggested to be undertaken were: (a) strengthening the enforcement of the existing laws and regulations by the SEC and PSE, particularly those involving insider trading, tender offer rules and disclosure; (b) improving the protection of minority shareholder rights through better enforcement; (c) strengthening the monitoring of compliance with IAS/IFRS and requiring additional disclosure of internal controls and governance issues by listed firms; (d) enhancing PSE's surveillance system for monitoring of unusual trading activities; and (e) encouraging the development of advocacy institutions to promote minority shareholders rights. Out of these five recommendations, only two – namely the monitoring of compliance with IAS/IFRS and the enhancing PSE's surveillance system – have been complied so far. The other three recommendations are still in the works.

The SEC and the PSE conduct independent test of compliance with IAS/IFRS. Other initiatives undertaken by the PSE include the acquisition and installation of the state-of-the-art Advance Warning and Control System (AWACS) which has the capacity to track inside traders and stock price manipulators. PSE has also intensified the enforcement of the various disclosure rules (10-minute rule, selective disclosure rule, black-out rule and IAS-compliant financial reports).

- 10-minute Rule requires that a listed company disclose material non-public information to the public within 10 minutes from the occurrence of the event.
- Black-out Rule disallows insiders (e.g., directors and officers) from trading their company's shares until two full trading days have lapsed after the material non-public information is disclosed to the public.
- Selective Disclosure Rule prohibits a listed company from disclosing material non-public information to a selected group of persons without simultaneously disclosing to the public.
- Audited financial statements of listed companies should be IAS-compliant.
- PSE polices the conduct of traders and salesmen in accordance to the Code of Conduct and Professional Ethics for Traders and Salesmen. This Code commits to the protection of the investing public by finding ways and means to prevent and discourage the commission of any form of abuse, exploitation, misrepresentation, manipulation and other fraudulent and illegal acts and practices in securities transactions by all concerned market players. It emphasizes the importance of maintaining professionalism within the ranks of traders and salesmen by instructing them to subordinate their personal interest to that of their customers with respect to all matters pertaining to securities transaction in or outside the Exchange.
- PSE and Securities Clearing Corporation of the Philippines (SCCP) stepped up efforts to improve risk management practices to restore investor confidence with the imposition of the 20 percent haircut on securities submitted as collateral. This will effectively result in additional shares being delivered in order to achieve full collateralization.
- PSE is set to increase the trading band or the cap in the increases and declines of stock prices from 50-40 percent to a 50 percent-cap in both instances. The new trading band rule will be implemented once the new trading system is in place.

Furthermore, the PSE created the Market Integrity Board (MIB), which is composed of five members - the Chairperson, the vice-chair, an independent director and two non-director trading participants of PSE. It acts as the Exchange's independent body exercising control and supervision over the PSE's Market Regulation Division (MRB). While the MRB has the line function of policing the activities of traders and listed companies and ensures they adhere to rules and code of conduct of the PSE and all related regulatory requirements, the MIB enforces the relevant rules and regulations that PSE has adopted to maintain market's integrity and minimize risks of the investing public. The MIB also initiates policy and structural changes to better protect the investing public, complementing efforts of the PSE's Board of Directors and the SEC.

In collaboration with SEC and Institute of Corporate Directors (ICD), PSE has institutionalized the corporate governance scorecard for publicly listed companies. All listed companies are currently required to periodically report to PSE their compliance with their respective Manual of Corporate Governance and ensure that a portion of their annual reports is devoted on the discussion of their compliance with corporate governance standards. Listed companies are to maintain an active website wherein they should upload the disclosures made to the SEC and PSE as well as their corporate governance report.

The creation of the Corporate Governance Office in the PSE, funded by the UK government, aims to support the fundamental functions of corporate governance, enterprise risk management, strategy management, and corporate social responsibility. It also embarked on a Corporate Governance Improvement Program (CGIP), which involves the development and conduct of various corporate governance-related initiatives in the PSE. CGIP will intensify PSE's presence and profile in the regional corporate governance community. This office is also envisioned to provide assistance to listed companies and trading participants on governance issues.

To promote the local adoption of world-class good corporate governance practices, the PSE has forged a tie up with the Management Association of the Philippines (MAP) in holding the Best Annual Reports (BAR) Awards. The competition began in 2002 and aims to promote good corporate governance by showcasing companies that observe the principles of transparency, accountability and fairness, particularly in their reporting formats. It also gives recognition to companies that produce user-friendly annual reports. Table 6 lists the BAR winners from 2002 to 2008.[6] Cayanan (2007) noted that though there was notable improvement in the level of compliance by listed Philippine companies with financial reporting standards, compliance is still far from ideal.

Table 6
BAR Winners from 2002 to 2008

Year	Best Annual Report	First Runner Up	Second Runner Up
2002	Macroasia Corporation	Aboitiz Equity Ventures	Keppel Philippines Marine, Inc.
2003	Aboitiz Transport System Corp.	PLDT	Macroasia Corporation
2004	PLDT	Aboitiz Transport System Corp.	First Philippine Holdings Corp.
2005	Macroasia Corporation	Aboitiz Transport System Corp.	Manila Water Company
2006	Macroasia Corporation	Globe Telecom	Manila Water Company
2007	Manila Water Company	Globe Telecom	Aboitiz Transport System Corp.
2008	PLDT	Manila Water Company	Cebu Holdings, Inc.

Source: Arnold Salvador, MAP Executive Director

A joint report by Asian Corporate Governance Association (ACGA) and Credit Lyonnais Securities Asia (CLSA) Asia-Pacific Markets, rating corporate governance quality in Asia, is shown below in Table 7. Table 8 shows the breakdown of the scores contained in Table 7.

Table 7
CG Watch Survey

Market	2004[1]	2005[2]	2007[3]
Hong Kong	67	69	67
Singapore	75	70	65
India	62	61	56
Taiwan	55	52	54
Japan	-	-	51
Korea	58	50	49
Malaysia	60	56	49
Thailand	53	50	47
China	48	44	45
Philippines	**50**	**48**	**41**
Indonesia	40	37	37

1 - Introduced a detailed survey and scoring methodology in 2004.
2 – Made the methodology more rigorous in 2005.
3 – Enhanced the methodology further in 2007 (No survey in 2006).

Table 8
CG Watch 2007 Category Scores

Market	CG Rules & Practices	Enforcement	Political/ Regulatory	IGA AP	CG Culture	Total
Hong Kong	60	56	73	83	61	67
Singapore	70	50	65	88	53	65
India	59	38	58	75	50	56
Taiwan	49	47	60	70	46	54
Japan	43	46	52	72	49	52
Korea	45	39	48	68	43	49
Malaysia	44	35	56	78	33	49
Thailand	58	36	31	70	39	47
China	43	33	52	73	25	45
Philippines	**39**	**19**	**38**	**75**	**36**	**41**
Indonesia	39	22	35	65	25	37

Source: "CG Watch 2007", ACGA & CLSA Asia-Pacific Market

Table 8 reinforces the findings of the World Bank and Echanis (2006) that not only does the Philippines corporate governance reforms focused mainly in the matching of its accounting and auditing standards to international norms, but there is also weakness in the enforceability of the laws, as well as in the powers of the regulatory/supervisory agencies (Echanis, 2006) .

The White Paper issued by OECD in October 2006 entitled "Implementing the White Paper on Corporate Governance in Asia" also provides valuable source of information regarding the status and progress in corporate governance reforms in Asia. This is an update of the 2003 White Paper. The White Papers are the products of public dialogues among policy makers, private sector and other relevant market players like investors and stakeholders to proposed areas for improvement and formulate best practices to be adopted.

Though the ACGA noted that there are substantive improvements in Asia in the area of corporate governance, it also pointed out that regulators in many Asian nations are ill-equipped in enforcing the laws and regulations. Below is a list of ACGA's findings:

Area	Improvements
Financial Reporting	More detailed disclosure rules; faster reporting; quarterly reporting; disclosure of "material" events, director pay and director dealings.
Board composition and function	Introduction of independent directors, board committees, director training; higher expectations placed on directors; higher fees paid to directors.
Shareholder rights	Formal rights strengthened; retail activist groups formed; institutional investors started voting their shares and taking engagement more seriously.
Accounting/Auditing	Local accounting and auditing standards brought more into line with international standards; independent regulation of audit profession in some markets.
Regulatory enforcement	Financial regulators still under-equipped but there has been focus on enforcing listing rules and key securities laws (e.g. insider trading).

Source: ACGA Presentation Chubb, October 7, 2009.

Philippines corporate governance reforms versus its Asian neighbors

The Philippines did not lag behind in its corporate governance reforms though there still remains plenty of room for improvement. However, there is one item that stands out prominently in Table 8. Compared to some of our Asian neighbors, our regulatory bodies are not adequately staffed with appropriate personnel and are not well funded. This greatly impedes our corporate governance efforts. This also violates the first OECD Principle of requiring corporate governance framework to be backed by enforceable laws and regulations and effective enforcement agencies. Moreover, based on the World Bank study in 2006, our judiciary system is viewed to be a constraint to the development of the private and financial sector. While training programs for judges on business and commercial matters resulted in thorough and careful review of the cases by the Regional Trial Courts (RTCs), our judiciary system remains slow in the giving of final resolution and decision on many cases. In our Philippine judiciary system, decisions made by the RTCs can be appealed to the Court of Appeals and cases decided by the Court of Appeals can still be overturned by the Supreme Court. Seeking legal remedies is very costly and it takes a long time. This is considered a major hindrance in the corporate governance effort of protecting the shareholders and minority interest. However, the Philippines is not alone in this as many Asian countries encounter similar predicament. The OECD study also pointed out that most companies in Asia are predominantly owned by a few wealthy families. Hence, the need for external financing becomes minimal. Consequently, incentives to adopt good corporate governance practices may not be present, leading to abuse of the minority shareholders.

VI. CORPORATE GOVERNANCE FOCUS IN THE FUTURE

What are investors looking for in the coming decade? What are the significant governance issues in the near future? There are four major areas that would need substantial improvements. Below is a table that highlights the four key areas:

Improved financial reporting	**Strengthened shareholder rights**
• More detailed and/or quicker translation of reports. • Faster reporting deadlines. • Quick disclosure of stock-option grants. • Continuous disclosure of price-sensitive information.	• Improved proxy voting standards (earlier release of final annual general meeting agendas and voting by poll). • Stronger pre-emption rights. • Stricter rules on privatization or delisting.
More effective enforcement	**Better board practices**
• Clear and consistent signal to the market on how financial regulators will enforce. • Faster, fairer approach to dealing with insider trading and fraud. • Strengthen the powers of exchanges. • Exchanges should actively promote and enforce corporate governance codes. • Regulators should be more active in disclosing their enforcement actions and processes.	• Genuinely independent directors • Split of chairman and CEO especially in large family and state controlling companies. • More focus on linking board composition to strategic direction and needs. • More thought to be given to the choice of committees, how they operate and what they should achieve. • Continuous director training.

The International Financial Law Review[7] (2004) reported the following:

1) While four countries (Singapore, Malaysia, Indonesia and Thailand) have moved to a two-month deadline for reporting annual results, others have not.
2) Only Korea has been bold enough to pass a law allowing fully-fledged class actions for securities violations. China and Taiwan allow a variation on this theme and Thailand has a bill under consideration.
3) Only Hong Kong and Taiwan have brought in rules requiring the main resolutions at annual general meetings to be subject to a vote by poll rather than a show of hands.
4) Although Asia's largest markets have a national code of best practice based largely on international corporate governance standards, only India, Malaysia, Philippines and Taiwan

have a truly robust definition of independent director.

5) Regulators have shown a degree of ambivalence towards independent board committees. Only the audit committee has become mandatory in all Asian markets. While some countries require compulsory nomination committees, restrictions on the scope and power of the committee's operations dilute their effectiveness.
6) With the exception of Singapore and Taiwan, it is not easy for minority shareholders to remove a director convicted of fraud or other serious corporate crime.
7) Regulators and governments are more comfortable demanding high standards of accounting, auditing and financial reporting than asking companies to build strong internal controls and accountability structures or allowing minority shareholders to exercise some real influence over companies in which they are part-owners.

VII. SUMMARY AND CONCLUSIONS

The Philippines has not been short of reforms or lacking in laws that promote corporate governance. However, there are two inherent weaknesses in its legal and regulatory framework that critically impede the progress of the various governance initiatives. One of the more prominent weaknesses is the weak enforcement power of our regulatory bodies. This is primarily due to the lack of funding and qualified personnel. Likewise, our judiciary system remains ineffective in protecting the rights of shareholders and minority interest as it continues to be slow in the giving of final resolution and decision on cases. The light sanctions for non-compliance and the absence of serious penalties associated with fraud is another major hindrance. It is aptly observed by Cayanan (2007) that no one has yet been imprisoned for not complying with financial reporting standards. Though significant headway has been made in strengthening the accounting and auditing standards, the level of compliance to these standards by listed Philippine companies still needs further improvement.

The corporate governance field is quite new and dynamic. Corporate governance practices even in the most developed countries are far from being perfect. Changes and challenges in the business scenario will continue to dictate how good governance will evolve in the coming years. Efforts to come up with best practices will be ongoing. However, without an effective enforcement system to complement these best practices, all efforts will be wasted. Cheung (2006) proposed that ensuring the country has a strong legal and regulatory framework and an impartial judiciary is an important step, as is empowering regulators to act on violations of the securities rules. In short, the system is as good as the people comprising it. Moreover, the quest for corporate governance best practices should not be merely a compliance "in form" but "in substance". The desire for good corporate governance should come from within each participant and from the indomitable and unwavering spirit of enforcers to stick not only to the letters of the laws and regulations but the real essence behind the letters as aptly put by an author. Only then can true governance be attained.

NOTES

[1] Sources: http://www.abs-cbnnews.com/business/02/08/09/bsp-charges-18-execs-personnel-legacy-group-rural-banks and http://www.abs-cbnnews.com/nation/02/09/09/legacy-owner-not-included-bsp-raps

[2] Given the damage caused by the alleged perpetrator, The Philippine Star reported on February 28, 2010 that the detained legacy scam brains (Celso de los Angeles, et al.) were holding political caucuses in condominium suite. In the same news article, one congressman expressed extreme disappointment on how this scam was handled. He was quoted saying, "While contemporary American pyramiding culprit Bernard Madoff is now serving a prison term, De Los Angeles is holding political caucuses in the comfort of a condominium suite." He questioned why it is taking so long for the Department of Justice (DOJ) prosecutors to finish the preliminary investigation of the many criminal complaints against Mr. de los Angeles, including a string of non-bailable syndicated estafa cases and why pending warrants of arrest against Mr. de los Angeles have not been served.

[3] PSE's strategic agenda is to LEVEL UP. Each letter stands for a key area or initiative taken or to be taken by PSE to further improve its role as a SRO.
L-ist more companies and securities
E-xpand and educate investor base
V-alue and enforce corporate governance standards
E-nhance shareholder value
L-aunch new products and services
U-pgrade market infrastructure and human resources
P-artner with government and other stakeholders
(Source: PSE).

[4] A survey conducted by McKinsey & Co. in conjunction with Directorship Search Group and the Institutional Investors Institute, identified three areas needing improvement and greater transparency in companies in the U.S.: executive compensation, board accountability and the division of responsibilities between CEO and chairman (Cheung, 2006). This shows that the Sarbanes-Oxley Act still falls short in addressing all corporate governance problems.

[5] From the 1997 study by Cayanan and Valderama to the 2002 study by Echanis to the 2003 study by Agustin and to the 2004 study by Cayanan.

[6] The Aboitiz- and Ayala-owned companies dominated the roster of BAR winners. Their companies also dominated the top 20 finalists. Consequently, the Ayala and Aboitiz Group of companies have been cited as winners of the Special Award for Conglomerate (whose three or more companies made it to the top 20 finalists) together with SM and Metrobank Group of companies. Aside from the main award, there are special awards given by MAP, namely: 1) Best in Compliance with Philippine Financial Reporting Standards (PFRS) among Non-Financial Institutions; 2) Best in Compliance with PFRS among Financial Institutions; 3) Best in Corporate Governance Disclosure among Non-Financial Institution; 4) Best in Corporate Governance Disclosure among Financial Institution; 5) Best in Visual Design; 6) Special Award for Conglomerate; and 7) Most Improved Annual Report for the Past Three Years. From ten finalists in 2002 to 2004, the number of finalists grew to fifteen in 2005 and twenty in 2006 to 2008. While Security Bank and PSBank won the Best in Compliance with PFRS among Financial Institutions in 2007 and 2008, respectively, PSBank is the consistent winner for Best in Corporate Governance Disclosure among Financial Institutions since 2006.

[7] The International Financial Law Review (IFLR) is part of the Euromoney Legal Media Group that provides analysis and information on developments in financial markets to in-house counsel and practitioners.

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Appendix 1

Powers and Functions of the Commission
Section 5 of the Securities Regulation Code (RA 8799)

5.1 The Commission shall act with transparency and shall have the powers and functions provided by this Code, Presidential Decree No. 902-A, the Corporation Code, the Investment Houses Law, the Financing Company Act and other existing laws. Pursuant thereto the Commission shall have, among others, the following powers and functions:

a. Have jurisdiction and supervision over all corporations, partnerships or associations who are the grantees of primary franchises and/or a license or permit issued by the Government;
b. Formulate policies and recommendations on issues concerning the securities market, advise Congress and other government agencies on all aspects of the securities market and propose legislation and amendments thereto;
c. Approve, reject, suspend, revoke or require amendments to registration statements, and registration and licensing applications;
d. Regulate,, investigate or supervise the activities of persons to ensure compliance;
e. Supervise,, monitor, suspend or take over the activities of exchanges, clearing agencies and other SROs;
f. Impose sanctions for the violation of laws and the rules, regulations and orders issued pursuant thereto;
g. Prepare, approve, amend, or repeal rules, regulations and orders, and issue opinions and provide guidance on and supervise compliance with such rules, regulations and orders;
h. Enlist the aid and support of and/or deputize any and all enforcement agencies of the Government, civil or military as well as any private institution, corporation, firm,, association or person in the implementation of its powers and functions under this Code;
i. Issue cease and desist orders to prevent fraud or injury to the investing public;
j. Punish for contempt of the Commission, both direct and indirect, in accordance with the pertinent provisions of and penalties prescribed by the Rules of Court;
k. Compel the officers of any registered corporation or association to call meetings of stockholders or members thereof under its supervision;
l. Issue *subpoena duces tecum* and summon witnesses to appear in any proceedings of the Commission and in appropriate cases, order the examination, search and seizure of all documents, papers, files and records, tax returns, and books of accounts of any entity or person under investigation as may be necessary for the proper disposition of the cases before it, subject to the provisions of existing laws;
m. Suspend, or revoke, after proper notice and hearing the franchise or certificate of registration of corporations, partnershi9ps or associations, upon any of the grounds provided by law; and
n. Exercise such other powers as maybe provided by law as well as those which may be implied from, or which are necessary or incidental to the carrying out of, the express powers granted the Commission to achieve the objectives and purposes of these laws.

5.2 The Commission's jurisdiction over all cases enumerated under Section 5 of Presidential Decree No. 902-A is hereby transferred to the Courts of general jurisdiction or the appropriate Regional Trial Court: Provided, that the Supreme Court in the exercise of its authority may designate the Regional Trial Court branches that shall exercise jurisdiction over these cases. The Commission shall retain jurisdiction over pending cases involving intra-corporate disputes submitted for final resolution which should be resolved within one (1) year from the enactment of this Code. The Commission shall retain jurisdiction over pending suspension of payments/rehabilitation cases filed as of 30June 2000 until finally disposed.

Source: Securities Regulation Act

Appendix 2
Laws and Regulations under SEC's Purview

- **Securities Regulation Code (Republic Act No. 8799)**
  This law is enacted to establish a socially conscious, free market that regulates itself, encourage the widest participation of ownership in enterprises, enhance the democratization of wealth, promote the development of the capital market, protect investors, ensure full and fair disclosure about securities, minimize if not totally eliminate insider trading and other fraudulent or manipulative devices and practices which create distortions in the free market. It has specifically corporate governance in mind when this Act was enacted.
- **Corporation Code of the Philippines (Batasang Pambansa 68)**
  This law governed all aspects of a corporation from formation to dissolution. Although not all the rights of a stockholder are explicitly enumerated and discussed in the said Code, many of these rights were incorporated in the discussion of the various corporate powers.
- **Investment Company Act (Republic Act No. 2629)**
  The policy and purposes of this Act is to mitigate and to eliminate investment companies from acting in such a manner as to adversely affect the national public interest and the interest of the investors.
- **Investment Houses Law (Presidential Decree No. 129)**
  This law proposes measures to ensure that investment banks which underwrite securities and perform quasi-banking functions harmonize their operations with national monetary goals.
- **The Securitization Act of 2004 (Republic Act No. 9267)**
  This Act aims to promote the development of the capital market by supporting securitization, by providing a legal and regulatory framework for securitization and by creating a favorable market environment for a range of asset-backed securities. It rationalizes the rules, regulations and laws that impact upon the securitization process, particularly on matters of taxation and sale of real estate on installment. It eases the transaction costs in the capital market to improve trading.
- **Foreign Investments Act of 1991 (Republic Act No. 7042)**
  This Act has the grand vision of promoting foreign investments with the view of expanding livelihood and employment opportunities for Filipinos, enhance economic value of farm products, promote the welfare of Filipino consumers, expand the scope, quality and volume of exports and their access to foreign markets and/or transfer relevant technologies in agriculture, industry and support services. This Act was later amended to Republic Act No. 8179 which further liberalize foreign investments.
- **Lending Company Regulation Act of 2007 (Republic Act No. 9474)**
  This Act governs the establishment, operation and regulation of lending companies.
- **Personal Equity and Retirement Account Act of 2008 or commonly known as "PERA" (Republic Act No. 9505)**
  This Act establishes a provident personal savings plan to promote capital market development and savings mobilization. To qualify as a PERA investment product, the product must be non-speculative, readily marketable and with a track record of regular income payments to investors.
- **Credit Information System Act (Republic Act No. 9510)**
  This Act recognizes the need to establish a comprehensive and centralized credit information system for the collection and dissemination of fair and accurate information relevant to, or arising from, credit and credit-related activities of all entities participating in the financial system. It addresses the need for reliable credit information concerning the credit standing and track record of borrowers.

Source: SEC website (www.sec.gov.ph)

Appendix 3
Salient Findings of the Corporate Governance Study Conducted by AIM on 100 of the Largest Listed Companies in the Philippines

In each year from 2002 to 2007, the majority of the companies reviewed had eight to eleven directors.
In each year from 2002 to 2007, women constituted no more than 12% of all directors in the Top 100 companies.
In 2002, 62.5% of the companies identified their independent directors in their annual reports. By 2007, the number increased to 96%.
Between 2002 to 2007, companies with two independent directors more than doubled in number. In 2007, only two companies disclosed having no independent directors.
In 2002 and 2003, more companies reported having a Chairman simultaneously serving as CEO. Beginning 2004, this pattern reversed, with more companies reporting a separation of the two roles. By 2007, companies reporting a separation of the two roles more than doubled that reporting having the same person serving in both capacities.
From 2002 to 2007, the number of companies disclosing the family relationship between their Chairman and CEO increased from 7 in 2002 to 18 in 2007.
Between 2002 and 2006, most of the companies did not report the frequency of their board meetings in their annual report. In 2007, only 27 companies disclosed this information.
In 2002, the number of companies that disclosed information about executive compensation was 35. In 2007, all the 100 companies were disclosing this information. None of the companies, however, provided a breakdown of the executive compensation. Amounts were reported in aggregate.
In 2002 and 2003, fewer than 45 companies disclosed information regarding their related party transactions. By 2007, all the 100 companies disclosed this information albeit in varying degrees of detail.
By 2007, most of the 100 companies had adopted a corporate governance manual and were disclosing their corporate governance practices in their annual reports. As of 2007, only 60 of the 100 companies had implemented a performance evaluation system for directors and top officers.
In 2002, only 13.6% of the companies disclosed having an audit committee. In 2007, 93% complied with this requirement.
In 2002, fewer than 5 companies constituted the nomination and compensation committees. In 2007, majority of the companies complied. More and more top 100 companies also reported the existence of the risk management and corporate governance committees.
Ownership concentration in Philippine companies remained high as of 2007. High concentration of ownership bears on corporate governance in that there is a need for mechanisms to protect the interest of the minority shareholders. Also, when a company does not rely on the capital markets for financing, there is less incentive to institute measures that would attract outside investors.

Source: Corporate Governance Trends in the 100 Largest Publicly Listed Companies in the Philippines, 2002 to 2007 by the Hills Program on Governance of the Ramon V.del Rosario, Sr. – C.V. Starr Center for Corporate Governance.